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No. 614

In the Supreme Court of the United States

OCTOBER TERM, 1958

JOHN C. O'CONNOR, AND THE O'CONNOR PATENT COMPANY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Constitutional provisions and statutes involved	2
Statement	2
Argument	3
Conclusion	5
Appendix	6

CITATIONS

Cases:	
Commissioner v. *Glenshaw Glass Co.*, 348 U. S. 426	3
Commissioner v. *Lane-Wells Co.*, 321 U. S. 219	4
Corona Daily v. *Corona*, 346 U. S. 833	4
Fox Film Corp. v. *Doyal*, 286 U. S. 123	3, 4
Lewis v. *United States*, 348 U. S. 419	4
Morris Inv. Corp. v. *Commissioner*, 134 F. 2d 774, certiorari denied, 320 U. S. 743	4
United States v. *Kahriger*, 345 U. S. 22	4
Constitution and statutes:	
Constitution of the United States:	
Art. I, Sec. 8:	
Clause 1	3, 6
Clause 8	3, 6
Sixteenth Amendment	3, 6
Internal Revenue Code of 1939:	
Sec. 22(a) (26 U.S.C. 1952 ed., Sec. 22(a))	3
Sec. 500 (26 U.S.C. 1952 ed., Sec. 500)	3, 6
Sec. 501(a) (26 U.S.C. 1952 ed., Sec. 501(a))	2, 3, 7
Sec. 502(a) (26 U.S.C. 1952 ed., Sec. 502(a))	3, 8
Sec. 502(g) (26 U.S.C. 1952 ed., Sec. 502(g))	8

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OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. lb-23b) are not reported. The *per curiam* opinion of the Court of Appeals (Pet. 29) is reported at 260 F. 2d 358.

JURISDICTION

The judgment of the Court of Appeals was entered on October 31, 1958. (Pet. 29.) The petition for a writ of certiorari was filed on December 30, 1958. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1).

QUESTION PRESENTED

Whether the provisions of the Internal Revenue Code of 1939 imposing a personal holding company surtax upon undistributed net income from patent royalties are unconstitutional.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The pertinent constitutional provisions and statutes are printed in the Appendix, *infra*, pp. 6-8.

STATEMENT

The relevant facts are undisputed and are set forth in the findings of fact of the Tax Court. (R. 1b-10b.)[1] John C. O'Connor held certain patents covering his inventions, which he transferred to the O'Connor Patent Company. (R. 3b, 6b.) More than fifty percent of the stock of the Patent Company was owned by O'Connor individually (R. 10b), and at least eighty per cent of the gross income of the Company consisted of patent royalties (R. 9b-10b). Accordingly, the Tax Court found that the Patent Company was a personal holding company within the meaning of Section 501(a)(1) of the Internal Revenue Code of 1939, and that its income was personal holding company income subject to the personal holding company surtax. (R. 10b, 16b-17b, 19b-22b). The Court of Appeals affirmed in a *per curiam* opinion. (Pet. 29.)

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[1] A number of issues were litigated in the Tax Court, but all except the question of the constitutionality of the personal holding company surtax as applied to income from patent royalties were abandoned on appeal. The O'Connor Patent Company is the only taxpayer involved in this question, and hence the only proper petitioner here.

ARGUMENT

The decision below, affirming that of the Tax Court, is clearly correct. There is no conflict or other occasion for further review.

The taxpayer corporation's contention that Congress exceeded its constitutional authority to levy taxes (Article I, Section 8, Clause 1, Sixteenth Amendment; Appendix, *infra*, p. 6) by subjecting personal holding companies to surtax on undistributed income derived from patent royalties (Sections 500-502 of the Internal Revenue Code of 1939, Appendix, *infra*, pp. 6-8) is plainly without substance and was properly rejected by both courts below. The contention rests on the novel assumption that the constitutional provision authorizing Congress to grant to authors and inventors exclusive rights in their writings and discoveries (Article I, Section 8, Clause 8: Appendix, *infra*, p. 6), and the implementing statutes, accord special tax immunities to authors, inventors and to corporations to which they assign their statutory rights. There is no basis for this assumption. On the contrary, royalties from patents or copyrights are to be treated, for tax purposes, like other income-producing property. *Fox Film Corp.* v. *Doyal*, 286 U.S. 123, 127-129.

In broadly defining "gross income" as income "derived from any source whatever" (Section 22(a) of the Internal Revenue Code of 1939), Congress intended to exercise "the full measure of its taxing power". *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 429-430. Income derived from property, consisting of statutory patent rights is no less subject to tax than income derived from other forms of income-producing property. *Fox Film Corp.* v. *Doyal, supra.* Congress unquestionably has the constitutional power to tax

income realized by the inventor himself from the exclusive statutory right to his invention (whether in the form of gain from a sale of the patents or royalties from a license), and from the inception of the income tax laws it has exercised that power without challenge. *A fortiori*, Congress has the power to tax such income in the hands of a corporation to which the inventor has transferred his exclusive rights; and where, as here, the corporation is also a "personal holding company" as defined in the taxing statute, Congress also has the power to impose a surtax on the undistributed portion of its net income. *Commissioner* v. *Lane-Wells Co.*, 321 U.S. 219; *Morris Inv. Corp.* v. *Commissioner*, 134 F. 2d 774 (C.A. 3d), certiorari denied, 320 U.S. 743. As this Court said in *Fox Film Corp.* v. *Doyal*, *supra* (p. 129), "the mere fact that a property right is created by statute to fulfil a governmental purpose does not make it nontaxable when it is held in private ownership, and exercised for private advantage."

The cases with which the taxpayer asserts a "conflict in principle" (Pet. 24-25) involved questions far removed from that presented by this petition, and, indeed, entirely different statutory provisions. To the extent that they have any bearing here, they cast no cloud on the decision below.[2]

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[2] In *United States* v. *Kahringer*, 345 U.S. 22, and *Lewis* v. *United States*, 348 U.S. 419, the constitutionality of occupational taxes on persons engaged in the gambling business was upheld. *Corona Daily* v. *Corona*, 346 U.S. 833, was a denial of certiorari, the Court refusing to review a decision upholding the constitutionality of a California license tax on the business of publishing a newspaper. The language quoted by taxpayer (Pet. 25) is from the dissent from the denial of certiorari.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JANUARY, 1959.

APPENDIX

Constitution of the United States:

ARTICLE I

SECTION 8. The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

* * * * *

To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries;

* * * * *

SIXTEENTH AMENDMENT

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Internal Revenue Code of 1939:

SEC. 500 [as amended by Sec. 181 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. SURTAX ON PERSONAL HOLDING COMPANIES.

There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1938, upon the undistributed subchapter A net income of every personal holding company (in addition to the taxes imposed by chapter 1) a surtax equal to the sum of the following:

(1) 75 per centum of the amount thereof not in excess of $2,000; plus

(2) 85 per centum of the amount thereof in excess of $2,000.

(26 U.S.C. 1952 ed., Sec. 500.)

SEC. 501. DEFINITION OF PERSONAL HOLDING COMPANY.

(a) *General Rule.*—For the purposes of this subchapter and chapter 1, the term "personal holding company" means any corporation if—

(1) *Gross income requirement.*—At least 80 per centum of its gross income for the taxable year is personal holding company income as defined in section 502; but if the corporation is a personal holding company with respect to any taxable year beginning after December 31, 1936, then, for each subsequent taxable year, the minimum percentage shall be 70 per centum in lieu of 80 per centum, until a taxable year during the whole of the last half of which the stock ownership required by paragraph (2) does not exist, or until the expiration of three consecutive taxable years in each of which less than 70 per centum of the gross income is personal holding company income; and

(2) *Stock ownership requirement.*—At any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals.

* * * * * *

(26 U.S.C. 1952 ed., Sec. 501.)

SEC. 502. PERSONAL HOLDING COMPANY INCOME.

For the purposes of this subchapter the term "personal holding company income" means the portion of the gross income which consists of:

(a) Dividends, interest (other than interest constituting rent as defined in subsection (g)), royalties (other than mineral, oil, or gas royalties), annuities.

* * * * *

(g) *Rents.*—Rents, unless constituting 50 per centum or more of the gross income. For the purposes of this subsection the term "rents" means compensation, however designated, for the use of, or right to use, property, and the interest on debts owed to the corporation, to the extent such debts represent the price for which real property held primarily for sale to customers in the ordinary course of its trade or business was sold or exchanged by the corporation; but does not include amounts constituting personal holding company income under subsection (f).

* * * * *

(26 U.S.C. 1952 ed., Sec. 502.)

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